



## Winding-up petitions and arbitration agreements

In a recently reported judgment, *Re Southwest Pacific Bauxite (HK) Ltd.* [2018] HKCFI 426, the Companies Court has brought Hong Kong law into alignment with Singapore and England when considering the effect of an arbitration agreement in a contract giving rise to the debt relied on to support a winding-up petition.

Previously in Hong Kong, neither the existence of an arbitration clause in a contract between the company and petitioner, nor the commencement of the arbitration was sufficient to demonstrate in the insolvency proceedings that the “debt” was bona fide disputed on substantial grounds (which is the test to be satisfied by a company facing a winding-up petition when seeking to demonstrate Hong Kong’s insolvency regime is inappropriate).

The Hong Kong Courts felt because the creditor did not seek to recover the sum due under the agreement containing the arbitration clause but instead sought to put an insolvent company into liquidation for the collective benefit of all its creditors, the arbitration clause was not relevant. Therefore, the company needed to establish in the normal way that the petitioner’s debt was disputed and it was only once it had successfully done so that the arbitration would come into the Court’s consideration.

### Facts

Southwest Pacific Bauxite (HK) Ltd. (the “**Company**”) is a joint venture holding 75% of a bauxite mine in the Solomon Islands.

Two of its six directors represented the interests of the Company’s minority shareholder, Lasmos Limited (“**Petitioner**”). The debt purportedly due to the Petitioner was the unpaid fees for its directors’ services to the Company. These fees were due pursuant to a Shareholders’ Agreement but there was no formula in the agreement to calculate the sums due. The Shareholders’ Agreement contained a typical Hong Kong arbitration clause requiring disputes to be resolved by a single arbitrator under the Hong Kong International Centre’s rules and administration.

The Petitioner asserted the fees it was due were agreed by the Company, and unpaid. It therefore issued a statutory demand in July 2017 and a winding-up petition on 27 October 2017.

## **Issues**

The Company disputed the amount of the fee due to the Petitioner and successfully struck-out the winding-up petition. The Companies Court held that the Petitioner should be bound by its contractual bargain to resolve the dispute by arbitration. It was therefore not open to it to bypass the arbitration agreement to pressure the Company to pay immediately in the face of the threat of insolvency.

In a change of approach, the Companies Court held that a winding-up petition would generally be dismissed if:

- i. A company disputes the debt relied on by the petitioner;
- ii. The contract under which the debt is alleged to arise contains an arbitration clause that covers the any dispute relating to the debt; and
- iii. The company takes any of the steps required under the arbitration clause to commence the agreed process and files evidence with the Court demonstrating this.

## **Limits of the judgment**

Although an agreement pursuant to which the debt is said to arise contains an arbitration clause, this does not mean that the Companies Court will strike-out every such winding-up petition.

If, for example, no evidence is filed by the company to demonstrate any steps were being taken to arbitrate the dispute, or the debt was admitted, it seems that then any application to strike-out the winding-up application would be dismissed.

Further, the presence of the arbitration clause does not oust the Companies' Court's jurisdiction if assets have gone missing and the Court felt there was an urgent need to appoint independent persons to investigate what had happened. If the appointment of provisional liquidators was justified a petition could be issued and stayed pending the outcome of the arbitration other than with respect to the steps relevant to the provisional liquidator.

## **Conclusion**

Those creditors who have chosen arbitration as a means to resolve their disputes will need to, in the future, think very carefully about utilizing the insolvency regime until they are in possession of an arbitral award for a liquidated sum.

## **Other applications**

It will be interesting to see if the Bankruptcy Court will also in the future hold that contracts with arbitration clauses between a petitioner and individual would also allow a bankruptcy petition to be struck-out or statutory demand to be set aside.

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